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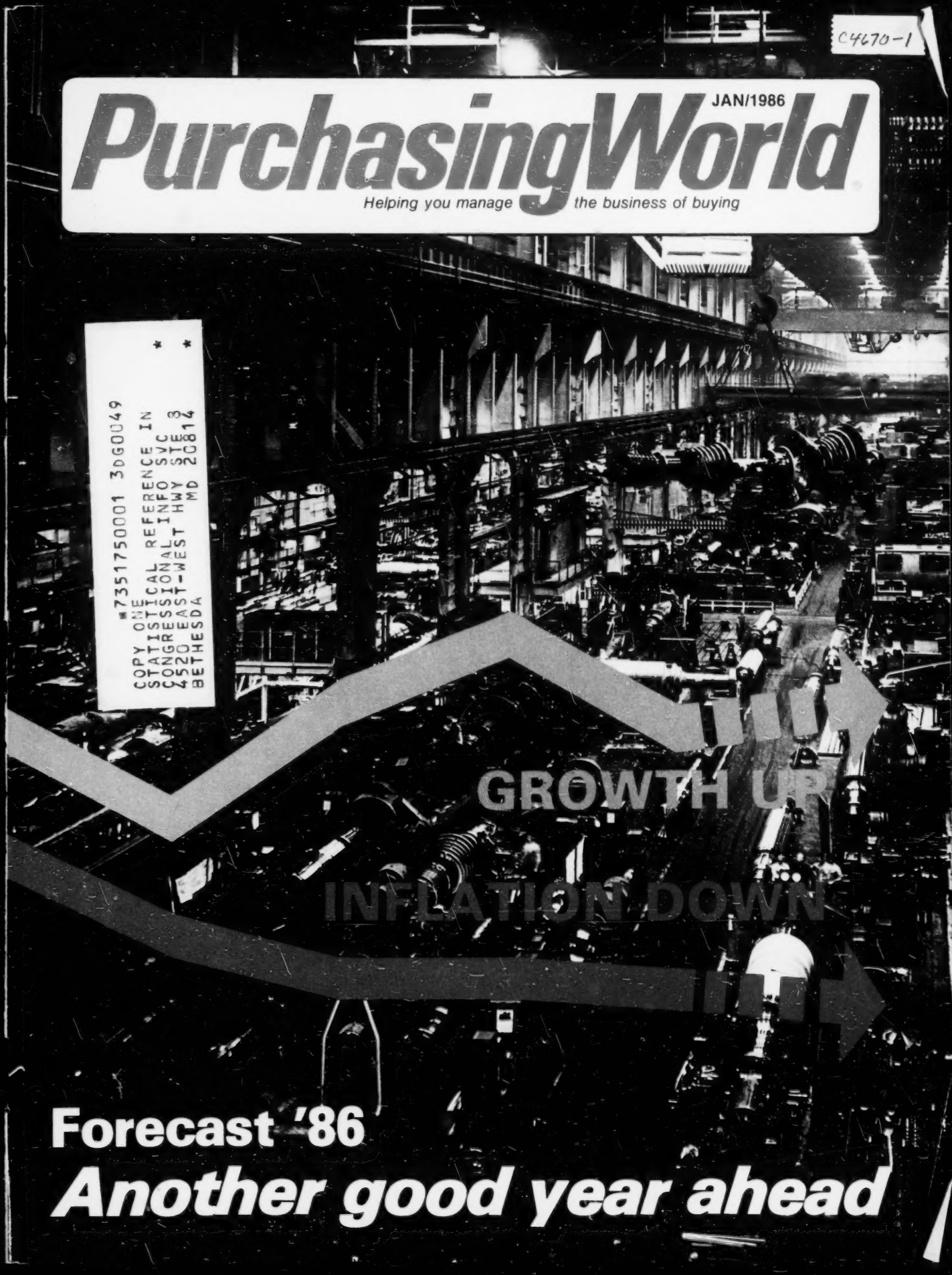

Forecast '86

Another good year ahead

PurchasingWorld

January 1986
Vol. 30 No. 1

Forecast '86: Count a modest cadence for 1986

Compiled by executive editor Robert Reichard

40 Paradiso's prognosis: Economy is alive and well in year four
Real GNP advance for 1986 will continue at the same pace as 1984, posting about a 2.6% increase for the year, says *PW*'s forecasting expert Dr. Louis J. Paradiso. Key signs of economic health point to steady momentum with a minimal amount of inflation.

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Top execs say they expect demand for their products to hold up a little better than in 1984—at 3.5%.

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Working with its transportation carriers and industry groups, GM's Buick City has implemented a broad ranging communications' system to support the ultra-high service levels required for its innovative J-I-T programs.

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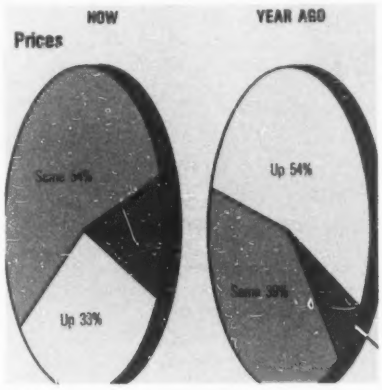

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Cover photo courtesy of General Electric Co

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PW PREDICTS

Robert S. Reichard, executive editor

A rarity of agreement

It's a rare phenomenon when you can get any two economic experts to agree on a forecast. Rarer still is getting near unanimous agreement among several. But that's the situation this year with *PW*'s Forecast '86 experts on the price outlook. The consensus: 1986 will be another year of easy prices—with buyers, rather than sellers, calling the signals.

Expect some moderate and scattered price advances in the year ahead, but they will be nothing like you would expect for a business recovery moving into its fourth year.

What makes this forecast consensus even more impressive is that it comes from diverse sources—buyers, sellers, business analysts, and econometric models.

On the purchasing front, for example, buyers responding to a new nationwide *PurchasingWorld* survey put the average increase in their 1986 procurement costs at 2.8%.

This prognosis is also verified by the NAPM Business Survey Committee. Some two out of three members hope to either hold the price line or effect scattered price declines over the next six months. 97% say any price increases will be moderate.

Suppliers—generally a more bullish lot—tell much the same story. They see an average 1986 advance for their products of only 2.7%—close to *PW* readers' estimate of 2.8%.

Even the top economists are of the same mind. Wharton Econometric's Dr. Nariman Behravesh sees the aggregate producer price index rising by less than 3%. And *PW*'s veteran forecaster Dr. Louis J. Paradiso, looking at the finished producer price index (which includes food), is even more optimistic—seeing only a 0.5% increase.

The four econometric models regularly monitored by *PW* suggest only an average 2% rise in the finished goods producer price index over the next 12 months. And the more service-oriented GNP price deflator is expected to rise by only 3.5%—just a bit under the 3.7% figure posted in 1985.

Nor are these favorable econometric projections limited to the big macro yardsticks. DRI, presenting details for some 26 subgroups, forecasts 23 of them will end up with increases of 4% or less.

These sanguine predictions are all the more convincing because they are based on essentially the same reasoning. All sources, for example, cite the fact that there is more-than-ample capacity around.

The cost side of the price equation also promises restraint partially because of continuing pressure on raw materials and component parts prices.

Thus, (1) unit labor costs will remain under control (up perhaps only 2-3% this year), (2) energy tabs will continue to weaken as crude oil drops at least another $1/bbl later on in the year, and (3) borrowing costs should edge a bit lower.

Energy Prices

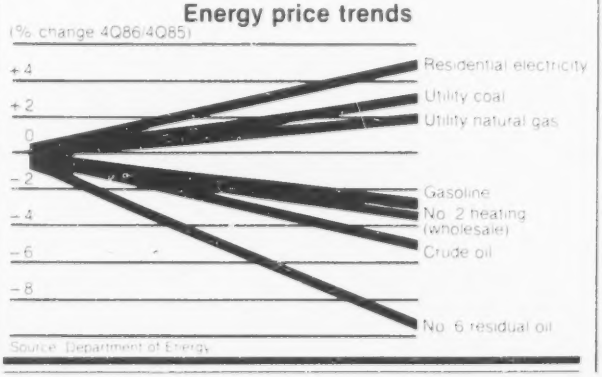
Figure on another good year for energy costs—with some declines in the petroleum product sector offsetting small advances in natural gas, coal, and electricity.

If we assume only a $1/bbl decline in crude oil (and this is probably conservative considering OPEC's decision to slug it out in the marketplace) total energy costs should be up only 1.4% in 1986. Prior to the recent OPEC meeting, Department of Energy forecasts predicted the following changes in energy sectors:

- **Gasoline:** The average price for all grades is expected to fall to near $1.14/gal by late 1986—off about 4¢/gal from estimated fourth quarter 1985 levels. Consumption meantime could be off about 0.6%.
- **Heating oil:** Current winter tags will be 2¢/gal higher than a year ago because of low stocks. But subsequent price declines, reflecting softer crude tags, should bring the wholesale No. 2 grade down 3¢/gal.
- **Residual fuel oil:** Price weakness is compounded by declining consumption—expected to be off 4% in 1986 on top of 1985's 12% drop.
- **Natural gas:** About a 2% increase is expected over the next 12 months.
- **Coal:** Bolstered by reduced stocks, the industry could bring prices up 3% by late 1986
- **Electricity:** Slightly better than a 4% price boost is anticipated over the next 12 months—with late 1986 residential average increases put at 8.24¢/kwh.

Note: This scenario could change dramatically if some recent predictions by many energy analysts prove correct that the benchmark price for Saudi light crude could drop as low as $18/bbl *(See "Energy price drop would prod all sectors over projections" in the April, 1985 issue of PurchasingWorld).*

Energy price trends



PW PREDICTS

Chemicals

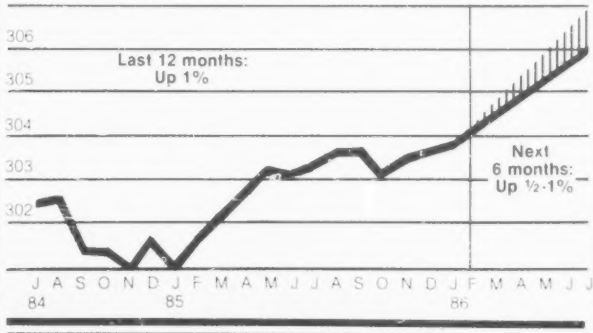
CURRENT SITUATION: Discount the spate of 1Q price hikes. That's the normal pattern for this time of year. If recent history is any measure, many of the boosts will either fail or be watered down. There's no doubt that it's a continued buyers' market. Despite modest demand gains, price averages advanced by only about 1%. **Overcapacity, weak petroleum feedstock costs, and import competition have put a lid on new advances.**

DEMAND: Look for about a 1-2% increase in chemical production in 1986—less than the expected GNP advance. That's below 1985's 3.5% increase and the 6.8% jump recorded in 1984. **But there could be significant differences among the many subgroups that make up this complex industry.** Best showings will be in synthetic materials (+6%) and drugs. Basic chemicals will show only a 1% advance.

SUPPLY: No probems are seen anywhere. Overcapacity is the rule in almost all sectors. The average U.S. chemical plant is operating at only 79% of capacity. And things are likely to stay that way as slow demand gains are offset by new capital investment advances (1% in 1986 and 7% in 1987). **Exacerbating the problem is all the new capacity coming on stream overseas—especially in Saudi Arabia where that nation's raw material position gives it the near-term capability of being the world's lowest cost producer.**

PRICE OUTLOOK: Increases should continue to be quite modest—with most quotes remaining well under official list levels. Look for about a 0.5-1% increase in overall transaction prices by midyear. The yearly average is up about 2%. Subgroup increases projected for 1986: industrial chemicals (1.5%), paint (1.5%), drugs (5%), ag chemicals (.5%), and plastic resins (2%). **Annual advances through 1995 should average out at 4%.**

Chemical prices
(Index 1967 = 100)



Aluminum

Competition is still keen. Alcoa is reportedly granting sharp 15-30% discounts to nail down Boeing's alloy sheet business for 1986 and 1987. But there are a few bullish signs too. Free World consumption remains in the plus column—up about 1.5% over the year just ended. An even larger 2-4% gain is anticipated for 1986. Free World stocks also continue to fall, causing a modest turnaround in market ingot where prices are up 2-3¢/lb from this year's recent mid-year lows. And they could well break past the 50¢/lb barrier by early spring if current demand and supply trends continue.

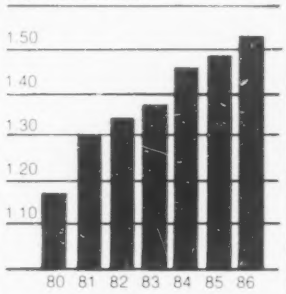
Polyethylene

Higher quotes are noted on both low-density (LDPE) and linear low-density (LLDPE) types—with prices averaging about 3¢/lb above late summer-early fall levels. Volume purchases of LDPE now go for 31-33¢/lb and LLDPE fetches 29-30¢/lb. High density polyethylene (HDPE) is also up about 3-4¢/lb—bringing the injection molding and blow molding grades up to 27-30¢/lb and 32-35¢/lb.

Magnesium

Expect to pay about 3% more as producers boost the basic ingot price by 5¢/lb to $1.53/lb. Cost pressures are blamed for the increase. But that should be it for quite a while as 1) Amex undercuts Dow in the die casting alloy sector (asking only $1.29/lb), and 2) Free-World stocks rise to 43,000 tonnes—the highest level in two years.

Magnesium
(Ingot prices $/lb.)



ABS plastic resins

Southeast Asian imports (from Taiwan and Korea) are causing some easiness. Softness is particularly prevalent in the west where overseas pipe grade material has gone for as low as 55¢/lb. Domestic grade pipe material, in turn, has also weakened a bit. Sales have been made in the 62-67¢/lb range—off about 3-5¢/lb from previous levels and considerably under the official 72¢/lb. Domestic operating rates also remain low—and could even drop to 65% in 1986 as new capacity comes on stream.

Copper

The red metal continues to drift. End-of-December quotes are still well under the year's 71¢/lb high. Lackluster demand is behind much of the softness as worldwide consump-

Steel

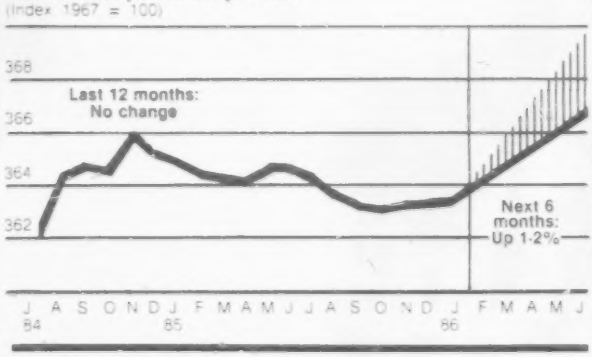
CURRENT SITUATION: Price boosts scheduled for this month are still up in the air. Mills want to restore the 10% or so that has been shaved off average steel prices this year—but the time may not be right. Hikes this big seem very high in light of recent flat demand. **Near-term shipment outlook isn't bullish and continuing import competition is still causing problems.**

DEMAND: 1986 domestic shipments will probably fall short of last year's 73 million-ton total. Don't count on more than 70 million tons for 1986. Reasons: declining auto needs and no real gains in other steel-using industries like machinery, construction, and oil and gas drilling. This could drop consumption to a few million tons under 1985's 95-96 million ton level. **Lower end use could also mean lower inventories.**

SUPPLY: Current low operating rates are expected to remain unchanged. Moreover, the industry's 1986 and 1987 capital spending plans suggest that domestic production potential will be static over the next few years. **Hefty imports are still a problem as the quota system fails to bring market share down.** 1985 foreign market share was at 24%. Reasons are obvious: lax enforcement, partial coverage of products and countries, and overly-eager attempts by foreign mills to circumvent the programs.

PRICE OUTLOOK: Some increases are likely—but not as much as suggested by recent reports—as both distributors and buyers begin to balk. **Best bet: only about a 3-5% increase in overall transaction prices by midyear.** Much of this will be in the form of discounts so official government yardsticks will be up less than that. **The price picture for 1986 depends on demand and on the exchange rate.** If the dollar continues to soften, it could make steel more expensive, giving domestic mills more leeway to nudge tags up further.

Steel Mill product prices
(Index 1967 = 100)



tion drops around 3-5% under 1984 levels. While a fractional gain is possible for 1986, it won't be nearly enough to push prices much above 70¢/lb. A similar pattern is projected for the longer term. U.S. mines will have to abandon about 35% of their current capacity—and settle for production rates of only about one million tons per year.

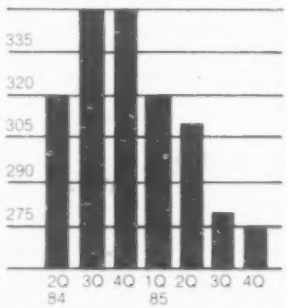
Machine tools

Prices may be ready to move up a bit. Blame it on the sinking dollar which has prompted at least one large Japanese supplier to raise its U.S. prices by about 10%. This firming trend is already showing up in machinery import prices where tags moved up 4% over the latest three-month period. All this could make for selective hikes in some domestically-made lines—both because of narrowing U.S. foreign price differentials and because offshore component parts entering these machines will cost more.

Linerboard

Prices remain extremely competitive—in recent months some transactions have been as low as $250/ton. But some turnaround seems likely before too long as 1) a weakening dollar has its impact, 2) temporary plant shutdowns reduce the supply overhang, and 3) demand shows some modest gains. Best bet: A move back into the $260/ton range by early spring. But any bounceback to the $350/ton peaks of 1984 seems unlikely given current forecasts for only a 92% average 1986 rate in this key paperboard sector.

Kraft Linerboard
(Transaction prices $/ton)



Benzene

The sharp fall-off in prices seems to be almost over. In fact, the near-term trend suggests considerable firming. First quarter 1986 contract prices, for example, will probably settle at around $1.25/gal (up 11¢ from recent lows). And in all likelihood, prices will climb to near $1.30/gal by early spring. Reasons: 1) supplies have tightened up recently, and 2) most of the chemical building block is now in the strong hands of contract sellers.

Metal castings

Imports are up significantly. The Cast Metals Federation puts the incoming shipments in seven key categories at double 1980 levels. That association also adds that import prices in these sectors are as much as 50% under comparable domestic

Business equipment

Soft prices for business equipment are likely to persist through the coming year.

Compare new Computer and Business Equipment Manufacturers Association (CBEMA) forecasts of sales dollars and number of units and the following unit price declines emerge: Microcomputers (off 9.2%); text-processing work stations (off 9.4%); electronic typewriters (off 3.4%); and office copiers (off 1.6%).

It should be emphasized that these numbers represent unit values (dollars divided by units), rather than prices, and can be distorted by changes in product mix. But, generally, they tend to support recent reports of a continuing downtrend in office product quotes.

Other key findings of the just-released study for 1986:

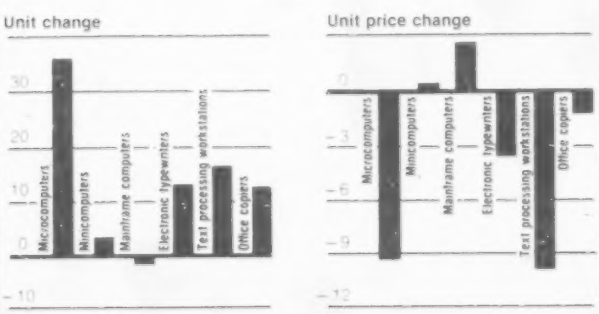
■ **Volume trends:** Declining prices will be more than offset by unit gains. A hefty 31% increase in microcomputers is anticipated, followed by text-processing work stations, electronic typewriters, and office copiers where unit gains of 18%, 13%, and 12%, respectively, are expected.

■ **Dollar sales trends:** Comparable advances here, taking both unit volume and prices into consideration, are as follows: microcomputers (18.5%), minicomputers (3.7%), mainframe computers (1.6%), electronic typewriters (8.7%), text processing work stations (6.2%), and office copiers (10.6%). CBEMA's estimate of additional sales are 2.8% for telecommunications equipment and 2.9% for manifold business forms.

CBEMA forecasts overall dollar gain for all the above sectors at 5%. That's fairly close to an 8% estimate just released by Henderson Ventures, a consulting firm that also monitors U.S. computer and office equipment markets.

The 1986 Business equipment outlook

(Percent)



Source: Computer and Business Equipment Manufacturers Assn.

products. But this could all change as the group presses for these big tariff increases: iron construction castings (40%), cast iron water main pressure pipe fittings (40%), steel valve castings (50%), cast iron compressor housings (50%), brake drums and rotors (35%), bronze ship propellers (50%), cast steel truck and machinery components (30-50%).

Semiconductors

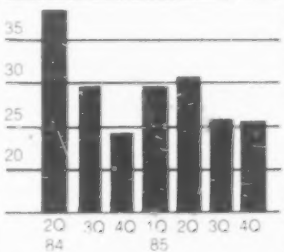
The big bargains of the past year may be a bit harder to come by in 1986—on a combination of expected demand gains and new hikes in Japanese prices. On the demand front, the World Semiconductor Trade Statistics program committee predicts a 35% increase in 1986 U.S. sales—followed by subsequent increases of 26% and 22% in 1987 and 1988. The Japanese have just announced plans to increase prices on all types of semiconductors by about 20% to reflect the recent depreciation of the dollar. But fear of being charged with "dumping" may also have played a role in their decision to raise prices.

Polyvinyl chloride

Prices are weakening again as pipe grade resins now fetch only about 25-26¢/lb (down a bit from early fall levels and a hefty 7.5¢/lb under quotes prevailing as recently as last April). On the other hand, some seasonal pickup is anticipated by spring. But these gains are likely to be quite modest because operating rates are not likely to go much above the 80% mark in 1986.

Polyvinyl chloride

p. e grade
(Transaction prices ¢/lb)

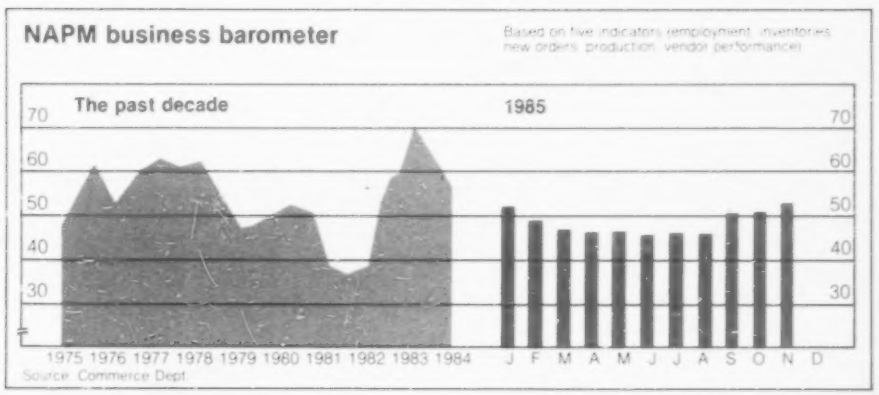


Zinc

Prices continue to hover in the low 30s because of overproduction and fractional global consumption gains. But modest firming is expected by the second quarter—as recent production cutbacks begin to have some impact. There also is very little excess material around—despite current softness. But the long-run prognosis can hardly be called bullish. Plans to open new mines—plus excess capacity—will limit any price recovery, with the metal hard pressed to average out at much above 35¢/lb over the next 6-12 months.

Don't miss PW's special report on software in the February issue

BUSINESS DATATRAK


NAPM business barometer
Based on five indicators (employment, inventories, new orders, production, vendor performance)
The past decade
1985
70
60
50
40
30
1975 1976 1977 1978 1979 1980 1981 1982 1983 1984
J F M A M J J A S O N D
Source: Commerce Dept.

KEY ECONOMIC TRENDS

Don't throw away your optimists' badge

The new year is starting out with pretty good expectations for the overall economic picture.

No one really expects any big near-term gains. But the leading indicators that signal basic business trends a few months ahead are now solidly in the plus column.

The NAPM Business Barometer—at 53.3—is significantly ahead of what it was in mid-1985. It is now at the highest level since July 1984 (see chart).

And the Department of Commerce index is about the same. Although gains have been small, the basic barometer has been in an upward trend for six consecutive months.

A closer look at some of the key sectors of the economy also supports a thesis of continued growth.

Also, look at hard goods. The stock-sales ratio is now at the lowest level in two years (see chart). This means that factories will have to raise output in the months immediately ahead to meet expected increases in final demand.

Even the capital goods sector is looking better. Even though machine tool orders are well under year-ago levels, they have perked up slightly over the last month or two (see chart). Machine tool builders say inquiries from automotive and aerospace industries have increased recently.

There are also some reports that Japanese producers, hit with a falling dollar, will raise prices. If they do, it could be a stimulus to hard-pressed American firms.

That isn't to say that the equipment industry doesn't face problems. Expectation of a decline in capital spending this year is certainly cause for concern. So are uncertainties about tax reform. Fewer tax breaks might dampen future capital spending.

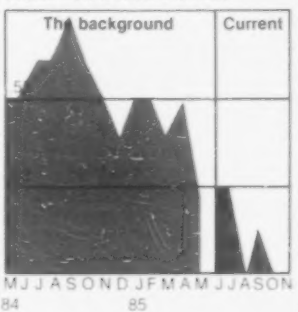
But consumers remain optimistic. A new survey by the Michigan Research Center, for example, again puts its Index of Consumer Sentiment above the 90 level (1966 = 100). That's the tenth consecutive quarter it has been in the 90's, the longest period in more than 15 years in which consumer optimism has remained at such a high level.

But consumer savings rates—well under traditional levels—could remain low for a while yet as (1) financial incentives for new auto purchases give a big push to sales and (2) a strong stock market provides many buyers with increased liquid asset values.

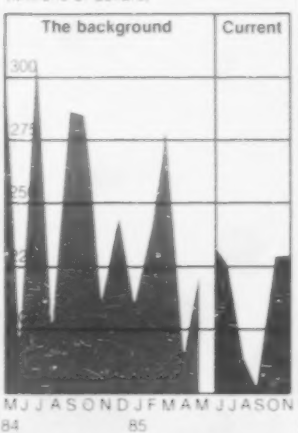
The high consumer debt doesn't seem to present any immediate problems either. A recent study by the Federal Reserve Board reveals that almost half the installment credit outstanding is owed by households in the highest income quintile—those most able to service this debt.

Leading indicators

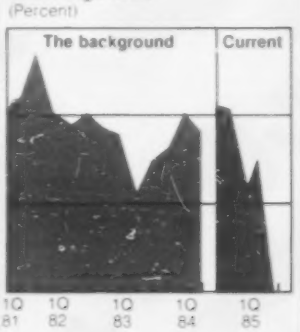
1. Inventory/Sales ratio
(Durable purchased material)



2. Machine tool orders
(Millions of dollars)



3. Savings ratio
(Percent)



Even housing is expected to hold up because of the modest drop in interest rates. Econometric models forecast the prime rate will average out at 9% in 1986. If correct, this could help push mortgage rates down even more.

Don't ignore the falling dollar—particularly in the medium-term rather than over the next few months. Prices of foreign goods are already beginning to rise following last year's 15% decline in the dollar. Sooner or later this will put a lid on imports.

Some rise on the horizon

The first tangible effects of dollar devaluation are beginning to show up.

Note from the chart that import prices are no longer falling. Although a lot more is needed to redress the trade imbalance, the dollar-inspired bottoming out of import prices does represent a sharp reversal from the previous 12 months.

Albeit there are still plenty of import bargains, but the gap between domestic and foreign quotes is probably as wide as it is going to get.

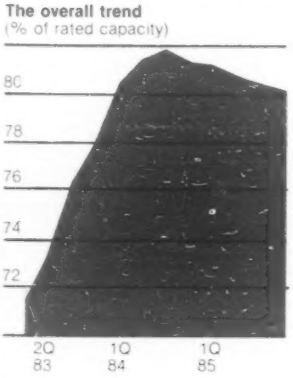
A look at some of the individual import sectors confirms the mixed price trend.

- **Crude materials:** Over the past three months prices for rubber were off 9.8% and pulp and waste paper were down 4.5%. Over the past decade, both of these product lines have fallen 20%.
- **Fuels:** Prices have dropped for the sixth consecutive quarter and are now nearly 8% under year-ago levels. Crude oil accounts for the biggest share of decline.
- **Chemicals:** Averages over the past quarter dropped 0.4%—led by declines in fertilizers and inorganic chemical elements. The overall decline for the entire year is estimated at 4.3%.
- **Intermediate products:** These products present a mixed picture. Although steel, textiles, and rubber manufactures suffered small declines, increases were posted over the last few months for nonmetallic mineral manufactures, wood manufacturing, paper products, and metal manufactures.

Import price trends

Source: Bureau of Labor Statistics

Factory Operating Rates Drift Lower



Current industry performance
(% of rated capacity)

Stone, clay, glass	80.9
Steel	68.2
Nonferrous	81.5
Fabric-metal products	80.5
Nonelectrical machinery	75.0
Electrical machinery	71.0
Automotive	80.6
Aerospace	87.4
Instruments	81.8
Textile products	85.2
Paper & products	92.3
Chemicals & products	78.8
Petroleum products	87.0
Rubber & plastic products	87.3

Source: Federal Reserve Board

- **Machinery and transport:** The trend here is upward. Overall 3-month advances are estimated at nearly 1%. Moving higher were general industry machinery (3.6%), specialized machinery (4.5%), and metalworking machinery (4.1%).

Why isn't the gap narrowing?

Things on the supply side seem to be getting easier rather than tighter.

The nation's most widely monitored measure of supply pressures, the factory operating rate, has been edging down for more than a year (see chart).

In most postwar recoveries, the operating rate has tended to rise steeply in the latter stages of recovery. Credit this current unusual condition to two factors: (1) the relatively slow rise in industrial production (up only 3% in the past 18 months) and (2) the increasing reliance on imports as an alternative source of goods.

Whatever the reasons, it is clear there is a big gap between the current level and the 85% operating rate level that has traditionally marked the dividing line between buyers' and sellers' markets. And, with industrial production slated to rise only 1-2% in 1986 (about matching the expected increase in new capacity), the overall factory utilization rate is likely to stay near current levels.

What's true of the aggregate operating rate also holds for most of the subgroups that make it up. Steel, for example, isn't likely to move much above its current upper-60s level anytime soon.

And machinery sectors aren't likely to move from their 70-75% range either if current projections calling for a leveling off in capital spending prove anywhere near true.

About the only major subgroup now (and it is likely to remain so) in the 90s range is paper.

In fact, every major industry is now, and should continue to be operating well under preferred levels. This should guarantee continuation of supply excesses and competitive infighting that was characteristic of this past year.

CURRENT PRICES

Staying on the money

The year has ended about where it began—with only fractional increases in industrial price averages. Preliminary indications suggest that this key inflation yardstick rose by less than 0.5% over the past twelve months.

Even this doesn't tell the whole story. Many product lines actually dropped over the year, including corrugated cartons (-6.5%), fuel oil (-21.8%), paper supplies (-3.1%), rubber belts and belting (-3.1%), synthetic fibers (-4.5%), and plastic resins (-2.9%).

And in energy, both gasoline and home heating oil rose, but this was offset by declines in coal, jet fuel, and residual oil (with the latter off 4% over the lat-

This month's breakdown

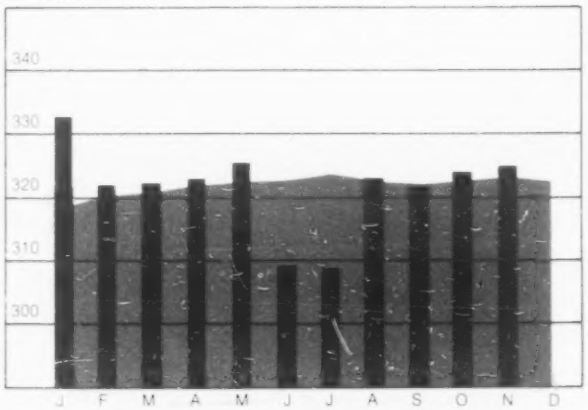
	Latest level (Nov.)	% change from: Month ago	Year ago
Bearings	354.3	-0.2	2.8
Bolts, nuts, etc	276.2	0.1	-0.3
Chemicals, inorganic	299.3	-0.3	-1.1
Chemicals, organic	350.8	-1.0	-0.3
Concrete products	324.0	0.2	3.9
Corrugated cartons	264.1	-0.3	-6.5
Cutting tools, small	267.0	0.0	1.1
Electric lamps (bulbs)	347.8	-0.1	2.9
Electronic components	197.8	0.1	0.4
Fans and blowers	359.7	0.0	2.3
Foundry and forge products	263.6	-0.1	0.2
Fuel oil (residual)	885.7	-4.2	-21.8
Furniture, commercial	311.3	0.0	3.5
Gasoline	568.2	2.6	0.9
Glass, flat	229.1	0.3	4.9
Glass containers	387.1	0.0	6.3
Gypsum products	349.5	2.9	4.5
Hand tools	376.9	0.1	3.5
Hand tools, power driven	234.7	0.0	3.8
Industrial furnaces	392.2	0.8	3.3
Integrating and measuring instruments	233.0	0.0	1.0
Internal combustion engines	346.8	0.0	2.6
Lubricating oil	N/A	N/A	N/A
Lumber millwork	312.2	-0.1	0.9
Material handling equipment	294.6	0.1	1.1
Metal containers	358.3	0.2	0.3
Metal mill shapes (nonferrous)	306.5	-0.4	-3.7
Metal tanks	305.4	0.1	-0.3
Motors and generators	351.1	-0.2	2.6
Motor trucks	312.6	0.1	7.5
Office and store equipment	154.1	-0.1	0.2
Paperboard	264.2	-0.6	-10.2
Paper boxes and shipping containers	266.0	-0.6	-2.9
Paper office supplies	236.0	-0.3	-3.1
Paint	277.2	-0.1	0.0
Plastic resins	299.9	-0.2	-2.9
Precision measuring tools	262.4	0.0	2.9
Pumps and compressors	359.5	0.3	1.8
Refractories	372.2	0.0	1.8
Rubber belts and belting	336.3	-1.8	-3.1
Scales and balances	228.9	0.0	-0.7
Steel products	363.0	-0.1	-0.6
Switchgear	281.4	1.0	0.9
Textiles, synthetic fibers	150.4	0.2	-4.5
Textiles, gray fabrics	151.1	0.2	-1.7
Tires and tubes	236.4	0.1	-0.8
Transformers and power regulators	231.9	0.2	1.0
Welding equipment	295.8	1.5	1.7
Wire and cable	205.2	0.0	2.0

Industrial prices

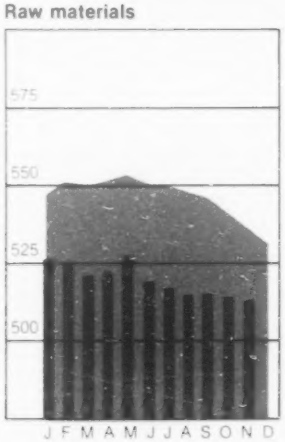
(Index 1967 = 100)

1984 ■ 1985 ■

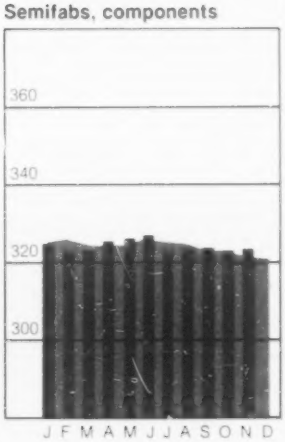
All items



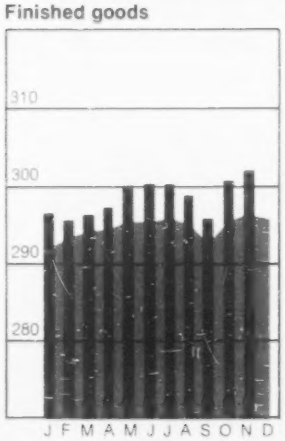
Raw materials



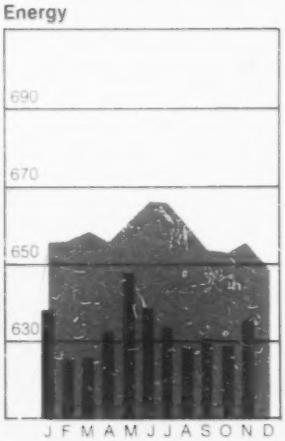
Semifabs, components



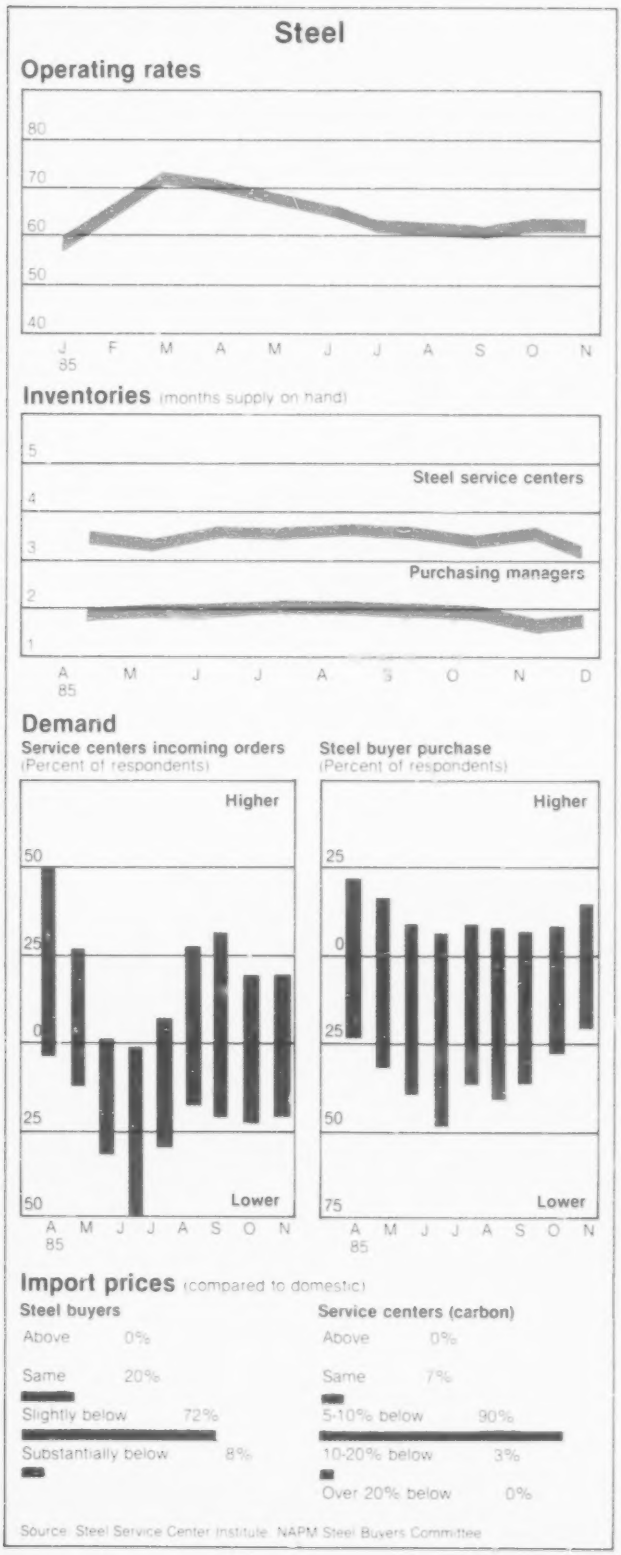
Finished goods



Energy



Source: Bureau of Labor Statistics



est 30-day period. Moreover, new declines in crude oil suggest more general weakness ahead.

Chemicals don't look as if they're about to move either. Latest figures show continuing declines in organic chemicals, inorganic chemicals, inedible fats and oils, and paint materials. Although some first quarter boosts have been announced, continued market imbalances indicate that many of them will not take.

A mixed picture also shapes up in construction materials as declines in lumber and plywood offset hikes in gypsum products, sand, and gravel.

Capital goods aren't going anywhere either. True, there were recent increases in the textile, mining, and chemical machinery sectors as well as in industrial furnaces. But these were minor, with overall capital goods tags moving up only 0.1%.

Finally, if there is any doubt about the overall price trend, take a look at the table alongside where close to one out of three products regularly monitored by *PW* moved lower over the past month.

STEEL SCENE

It's better than awful

Some modest near-term improvement in steel demand may be in the making.

Although the prognosis for the year is still not very exciting, there could be a temporary upward blip over the next few months. That's what a new distributor and steel buyer survey seems to say.

Some 22% of the members of the Steel Service Center Institute (SSCI) now see increases in orders over the next three months as opposed to 19% who anticipate further deterioration.

Cautious optimism is also reflected in new predictions by Andrew Sharkey, SSCI president, who now feels his group can sustain last year's shipment level of 21-21.5 million tons. But even he cautions against expecting any new gains.

But, as suggested above, first quarter buyer demand doesn't look all that bad. The 16% of PMs queried in the survey who say they expect to increase their receipts of steel over the next few months is the highest percentage recorded in two years.

On the other hand, this figure should be weighed against the 20% who still contemplate declines.

Inventory policies also seem to discourage any big demand gains. Despite significant drops in service center days' supply and maintenance of low levels by buyers, the feeling is that still more can be squeezed out.

On the service center side, for example, some 39% of the responding distributors currently contemplate inventory cutbacks over the next three months—more than double the 15% who feel some increases may be in order. This gap has narrowed from last month's reading of 61% for cutbacks and

only 8% for increases.

Buyers seem to be following suit with stocks. Again, expected parers outnumber expected accumulators and the gap between these two is also narrowing.

As in previous months, much of the inventory restraint can be traced to faster deliveries and the absence of any fear of shortages. Virtually everybody expects a problem-free early 1986 though there are some scattered mentions of possible difficulties.

Also, imports are expected to swell the amount of steel available. Few, for instance, feel that quotas will seriously cut down on import shipments.

On this point, Sharkey puts the import penetration level at around 22.5-23% for 1986—far higher than the administration had hoped for.

Continued reliance on imports is also suggested by service center responses to a question on dependence on foreign steel over the upcoming months. The 13% seeing increased dependency is the highest such reading in nearly two years and it offsets the 13% who will be cutting.

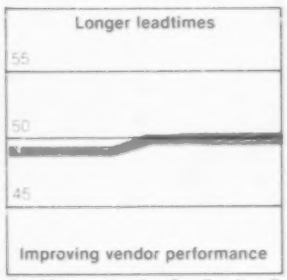
Once again, this is confirmed by buyers. Specifically, 16% now anticipate greater dependence—this pretty much offsets the 20% who see a decreasing role for steel imports.

One thing for sure, there is still a considerable price advantage in foreign steel. Some 93% of service centers say imported carbon steel is cheaper and 3% say the advantage is in the 11-20% range.

Monthly procurement status report

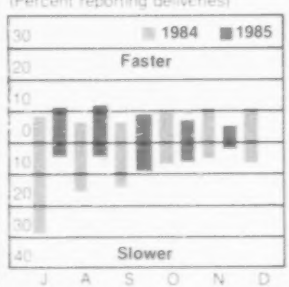
Leadtime index

A "diffusion" index based on 158 key commodities. Above "50" indicates a tendency for leadtimes to stretch out. Below "50" suggests improving vendor performance.

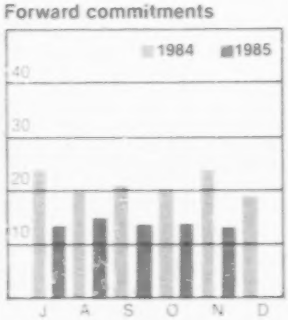


Delivery performance

(Percent reporting deliveries)

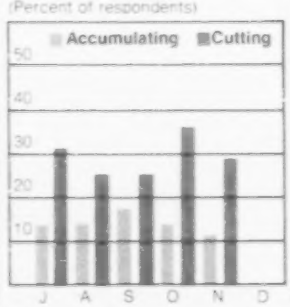


Forward commitments



Inventory strategy

(Percent of respondents)



Source: NAPM

PROCUREMENT STATUS

Staying glued

Early 1986 isn't going to be much different from either 1984 or 1985 when it comes to procurement. That's how buyers queried in *PW*'s latest procurement status survey see things. Their message in a nutshell: Buyers' markets are here to stay.

There is plenty of evidence to back up this conclusion. Leadtimes, for example, continue to hold steady despite the fact that industrial activity has moved up over the past few months. It is also reassuring that *PW*'s exclusive leadtime index remains stuck on the neutral "50" mark—indicating that any stretchouts are being offset by shrinking leads in other areas.

Vendor deliveries also continue to speed up. Of the buyers surveyed, 6% reported faster deliveries compared to only 2% who noted some slowdowns.

Buyers, looking at ready availability, continue to squeeze inventories. Not only are more buyers still paring (29%) than adding (12%), but forward commitments remain at extremely low levels—with only 13% buying 90 days or more in advance for production materials.

Prices continue easy, too. New NAPM survey findings tell the story—13% of buyers reporting price declines over the latest month, far outweighs the 2% who report increases.

The reasons for these favorable readings are readily apparent. While industrial activity has moved up, so has new capacity. So operating rates remain around 80%—well under the preferred level—and not one major procurement item is in short supply.

Also, there's the heavy import flow adding to the overall supply. The dollar decline could inhibit future gains. But there is a long lead time between the change in the value of the dollar and a change in import volume. Chances of any appreciable effect on trade totals before mid-1986 are slim.

Leadtimes and availability

Chicago: Hardware is in and is now a stock item. Also posting shrinking leadtimes (in weeks): Printed circuit boards (6-12), ICs (16-26) chlorine (1/2) and PVC resins (2). Specialty sheet and tube are in and stock sheet is out. Coated paper is out (to 6).

Cleveland: Mixed picture here. Moving out are maintenance paint (2-3), and plastic packaging (3-4). Coming in are hardwood lumber (1-2), softwood lumber (1-3), skids (1-3), plastic shrink film (on demand), and coil coating paint and polyethylene (2).

Los Angeles: Status quo here with these typical weekly leads: aluminum tubing (6-8), grey iron castings (8-10), brass castings (4-6), electromechanical devices (6-8), pumps (10-12), stainless coil (12-14), and std. fasteners (4).

BUSINESS DATATRAK

Houston: Not much change here but stretchouts on capital items are possible by spring. Typical weekly leads: Corrugated cartons (2), component parts (1-8), galvanized coils (10), and stainless fasteners (8-10).

Philadelphia: Modest shrinkage with these lower weekly waits: Std. fasteners (stock to 3), std. valves (3-4), PC boards (4-8), aluminum products (4-6), std. stainless rod (to 3), and plastic sheet (2-3).

Pittsburgh: Typical prevailing delays (in weeks): Paper bags (4-6), plastic bags (3-4), corrugated and folding boxes (3-4), wirebound boxes (4-5), drums (1), lumber (3-4), painted seals (6-8),steel strapping (2-3), paint (4-5), and alloying metals (2).

Latest spot market prices

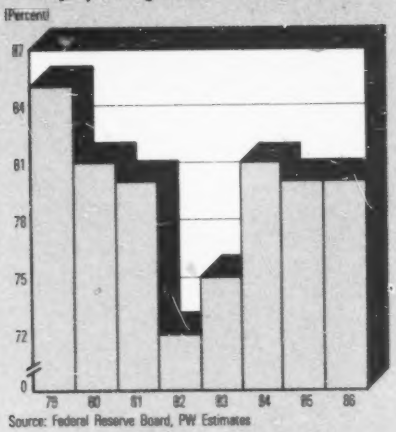
	Latest price	Previous month	Year ago
FERROUS METALS			
Pig iron, basic, valley, gross ton	213.00	213.00	213.00
Pig iron, Bessemer, Pitts., gross ton	213.00	213.00	213.00
Steel, billets, Pitts., net ton	367.00	367.00	367.00
Steel, structural shapes, Pitts., cwt	23.90	23.90	23.90
Steel, structural shapes, Chi., cwt	23.90	23.90	23.90
Steel, structural shapes, Los Angeles, cwt	23.90	23.90	25.10
Steel, bars, dlvd, Phila., cwt., merchant quality	23.95	23.95	23.95
Steel, bars, Pitts., cwt	23.95	23.95	23.95
Steel, bars, C.R., Pitts., cwt	29.25	29.25	29.25
Steel, plates, Pitts., cwt	23.25	23.25	23.25
Steel, plates, H.R., Pitts., cwt	23.25	23.25	23.25
Steel, sheets, C.R., Detroit, cwt	27.85	27.85	27.10
Steel, strip, C.R., Chi., cwt	36.18	36.18	35.30
Steel, basic wire, Pitts., cwt	23.65	23.65	23.65
NONFERROUS METALS			
Aluminum, ingot, lb. (market place)	0.468	0.445	0.538
Antimony, in alloy, lb.	2.00	2.00	2.00
Beryllium-copper, cost ingot, lb	5.35	5.35	5.20
Brass, red, 85%, [sheet], lb	1.31	1.30	1.25
Brass, yellow, [sheet], lb	1.26	1.25	1.20
Cadmium, ton lots, lb	1.00	1.00	1.25
Copper, electrolytic, wire bars, refd., lb	0.68	0.67	0.63
Copper sheet, over 24 in., lb	1.40	1.39	1.37
Lead, common, N.Y., lb	0.188	0.190	0.230
Magnesium, pig ingot, [99.8%], lb	1.53	1.48	1.48
Mercury, 20 fl. lots, N.Y., fl.	297.00	315.00	323.00
Molybdenum, oxide, dealer lb	2.60	2.65	3.05
Nickel, cathode, dealer lb	1.88	1.90	2.22
Platinum, dealer, oz.	346.00	328.00	327.00
Silver, N.Y., oz.	6.05	6.03	6.87
Tin, Straights, N.Y., lb.	N.A.	N.A.	6.02
Zinc, Prime West, East St. Louis, lb	0.33	0.36	0.45
Zinc, die casting alloy, No. 3, lb	0.415	0.425	0.515
PAPER			
Uncoated book #3 offset, ton	850.00	850.00	850.00
Watermarked bond, ton	985.00	985.00	985.00
Gummed sealing tape, carton	16.19	16.13	16.25
Boxboard, mach. clay ctd. recycled sheets 80 bright, .016, ton	495.00	495.00	495.00
Wrapping paper, std. distributor cost, kraft, basis wt. 50 lb., roll	28.00	28.00	28.00
Kraft linerboard, 42 lb., unbleached, ton	290.00	290.00	350.00
TEXTILES			
Burlap, 10 oz., 40", N.Y., yd.	0.215	0.240	0.400
Cotton drill, 1.85, 59", 68x49, N.Y., yd.	1.040	1.045	1.040
Cotton middling, 1", N.Y., lb.	0.560	0.568	0.603
Printcloth, 48", 80x80, N.Y., spot, yd.	0.72	0.68	0.78
Army duck, 37", 13 oz., yd.	1.56	1.30	1.78
Blended printcloth, 64", 78x54, yd.	0.800	0.850	0.700
20s combed yarns	1.95	1.95	2.12
Wool tops, N.Y., lb.	3.60	3.60	3.60

	Latest price	Previous month	Year ago
CHEMICALS			
Acrylonitrile, tanks, lb.	0.455	0.455	0.455
Ammonia, anhydrous, fertilizer, wholesale, tanks, ton	210.00	210.00	210.00
Benzene, petroleum, tanks, Houston, gal.	1.20	1.14	1.15
Caustic soda, 76% solid, drums, carlots, cwt.	26.00	26.00	26.00
Cresylic acid [over 25%], tanks, lb.	0.58	0.58	0.58
Formaldehyde, USP, 37% [12% to 15% meth.], tanks, lb.	0.106	0.106	0.106
Glycerine, synthetic, tanks, lb.	0.91	0.91	0.81
Methanol, syn., tanks, 4,000 gals., f.o.b. Gulf Coast plants	0.52	0.52	0.54
Naphthalene, crude, tanks, lb.	0.22	0.22	0.22
Phthalic anhydride, tanks, lb.	0.270	0.270	0.305
Polyethylene resin, low density liner film grade (market price), lb.	0.310	0.280	0.290
Polypropylene, homopolymer grade (market price), lb.	0.350	0.350	0.380
Polystyrene, general purpose grade (market price) lb.	0.350	0.350	0.370
Polyvinyl chloride, pipe grade (market price), lb.	.250	.260	.260
Soda ash, 58%, light carlots, cwt.	6.15	6.15	6.15
Styrene monomer, 99.6%, tanks, lb.	0.26	0.26	0.35
Sulphur, crude, ex-terminal, Tampa, Fla., lt.	157.50	157.50	162.50
Sulphuric acid, 66%, commercial, tanks, ton	66.86	66.86	56.85
Titanium dioxide, anatase, reg., carlots lb.	0.69	0.69	0.69
Xylene tanks, gal.	1.36	1.36	1.26
BUILDING MATERIALS			
Lumber, 2x4 fir, mbf, cl.	308.70	319.65	308.95
Lumber, 2x2, pine, mbf, cl.	294.05	298.00	286.15
Plywood, plyform, ¾", msf, cl.	578.85	582.30	573.05
Plywood, ¾", msf, cl.	367.75	381.80	379.15
Cement, bulk, ton, tl.	64.98	64.73	63.74
Sand, ton, cl.	6.41	6.36	6.23
Ready-mix concrete, 3,000 psi/cu yd., 15 cu. yd.	48.12	48.00	47.62
Crushed stone, 1½", ton, cl.	7.86	7.80	7.47
Concrete blocks, sand/gravel, 8"x8"x16", ea., tl.	0.82	0.82	0.79
Gypsum sheathing, ½"x1"x8", msf, tl.	212.99	212.44	206.40
Brick, common, per thousand, tl.	184.61	184.53	177.23
Asphalt paving, AC-20	176.14	175.86	172.14
Concrete sewer pipe, 12", prem. joint, per foot, cl.	7.14	7.14	7.13
FUELS			
Fuel oil, No. 6 or Bunker C, Gulf, bbl.	21.25	20.00	26.25
Fuel oil, No. 6 or Bunker C, N.Y., barge, bbl., reseller	28.75	27.75	30.75
Gasoline, 91 oct., reg., Los Angeles, rack, gal.	0.770	0.750	0.760
Gasoline, 94 oct., reg., Chi., tank car, gal.	0.798	0.813	0.723
Heating oil, No. 2, Chi., gal.	0.868	0.860	0.795
Heating oil, No. 2, N.Y., bulk, gal.	0.858	0.878	0.808
Heavy fuel, PS 400, Los Angeles, rack, bbl.	26.50	26.50	26.50
Jet kerosene, gal.	0.760	0.853	0.768
LP-Gas, propane, Okla., tank cars, gal. [incl. discount]	0.345	0.345	0.425
SCRAP MATERIALS			
Steel, No. 1, hvy., dlvd., Pitts., ton	69.00	69.00	81.00
Steel, No. 1, hvy., dlvd., Chi., ton	68.00	68.00	75.00
Copper, No. 1, East, wholesale buy, dlvd., lb.	0.565	0.550	0.545
Copper, No. 2, East, wholesale buy,	0.495	0.470	0.455
Brass, red, East, wholesale buy, dlvd., lb.	0.525	0.510	0.505
Brass, yellow, East, wholesale buy, dlvd., lb.	0.290	0.330	0.345
Alum., old sheet/cast, E., wholesale buy, dlvd., lb.	0.285	0.295	0.335
Alum., mixed clip., E., wholesale buy, dlvd., lb.	0.310	0.320	0.355
Zinc, old, East, wholesale buy, dlvd., lb.	0.110	0.110	0.200
Lead, clean solids, East, wholesale buy, dlvd., lb.	0.100	0.100	0.120
Paper, No. 1 mixed, dlr., N.Y., ton	Nom.	Nom.	Nom.
Paper, old corrug. box, dlr., Chi., ton	9.00	9.00	15.00
Paper, old corrug. box, dlr., N.Y., ton	7.00	7.00	10.00
Osnaburg cuttings, dlr., f.o.b. N.Y., lb.	0.085	0.090	0.120
White wipers, No. 1, dlr. buy, f.o.b. N.Y., lb.	0.15	0.16	0.35

[Sources: Metals Week, Engineering News-Record (20-city averages), Platt's Oilgram Price Service.]

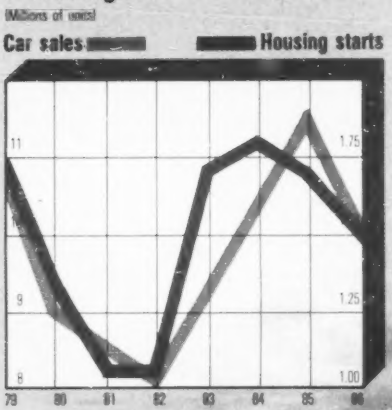
Supply availability: No sweat

Factory operating rates



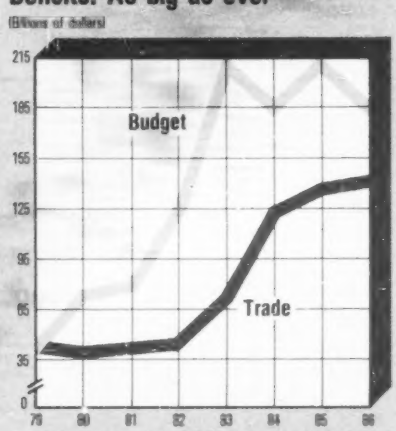
Source: Federal Reserve Board, PW Estimates

Big ticket consumer demand: A leveling off



Source: Commerce Dept., PW Estimates

Deficits: As big as ever



Source: Office of Management and the Budget, Commerce Dept., PW Estimates

Housing

The drop in mortgage rates from the highs of 15-16% of a few years ago to the 12-13% range is providing some impetus to housing starts which have held in the relatively high 1.7 million units range in 1985—fractionally under 1984's 1.8 million units.

There has been some dropoff in recent months from the 1.9 million units high of last spring and summer. This slowdown should continue in 1986 with only about 1.5 million units anticipated.

Main reasons for this are high consumer debt and uncertainty about the future. And while mortgage rates have come down, the trend to higher home prices has offset some of the "mortgage" effect.

Consumer spending

One of the big problems here is that personal consumption expenditures have been growing faster than after-tax income. This past year, for example, expenditures rose 3.9% while income went up less than 2%. The result is that the saving rate has dropped from a normal 6.1% in 1984 to only 4% in 1985.

This, of course, will not continue. A bounceback to a 5% savings rate can be anticipated in 1986 as consumers begin to pay off previously committed debt. In turn, this should limit the increase in personal consumption expenditures to only 3% in real terms in 1986.

This will clearly affect autos where recent purchases have siphoned off some of the 1986 potential. The estimated 11.5 million unit sales of 1985 should drop to about 9.5-10 million units in 1986. And imports could be an added problem with foreign car makers expected to take about 2.5-3.0 million of the total unit sales.

Budget deficit

The federal government's shortfall should remain in the $175-200 billion range in 1986. And this is an election year so chances of tax hikes are negligible. Revenue increases from existing taxes will also be limited as economic gains remain modest and profits drop a bit.

Trade deficit

The trade imbalance has been a significant factor in slowing down our economy over the last year or two. It's only recently that the deficit has shot up—reaching $123 billion in 1984—as a strong dollar priced many U.S. sellers out of international markets.

Over the past year, the deficit has continued to rise—hitting $135 billion. And next year it could be even higher—in the neighborhood of $140 billion.

The big question is: When and how much will a weakening dollar help? As of now, the weakening (15% off 1985 highs) has not been enough to make a noticeable difference. Historically, it has taken about a year for a change to have any dramatic effect on import flows.

Actually, we would need another 15% or so dollar erosion to make any meaningful dent in the trade deficit. Given other U.S. and foreign financial priorities, such a further decline does not seem to be in the cards—certainly not over the next few quarters. ***PW***

A chorus of optimists

The nation's top corporate executives are counting on a fairly good year in 1986—nothing sensational, mind you—but good enough to assure continued demand gains in most industries.

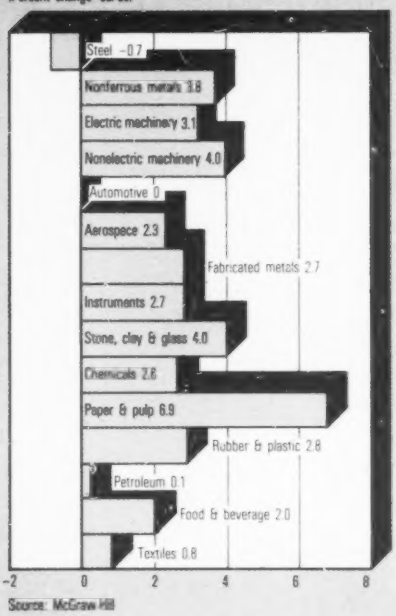
Top managers expect demand for their own firms' products to be up about 3.5%. That's better than 1984 when estimated real sales advanced only 3%.

A more cautious attitude exists on near-term pricing moves. These execs see prices on their products rising an average of 2.7%. A year ago, when asked about 1985, they projected increases of about 4%.

But this good news, culled from

Price hikes will be quite modest

(Percent change '86/'85)



Source: McGraw-Hill

McGraw-Hill's latest capital goods survey, is offset somewhat by what appears to be a lull in plant and equipment spending. When corrected for inflation, capital investment totals could be off 3-5% as excess capacity and corporate profit squeezes make many firms think twice about expansion or modernization.

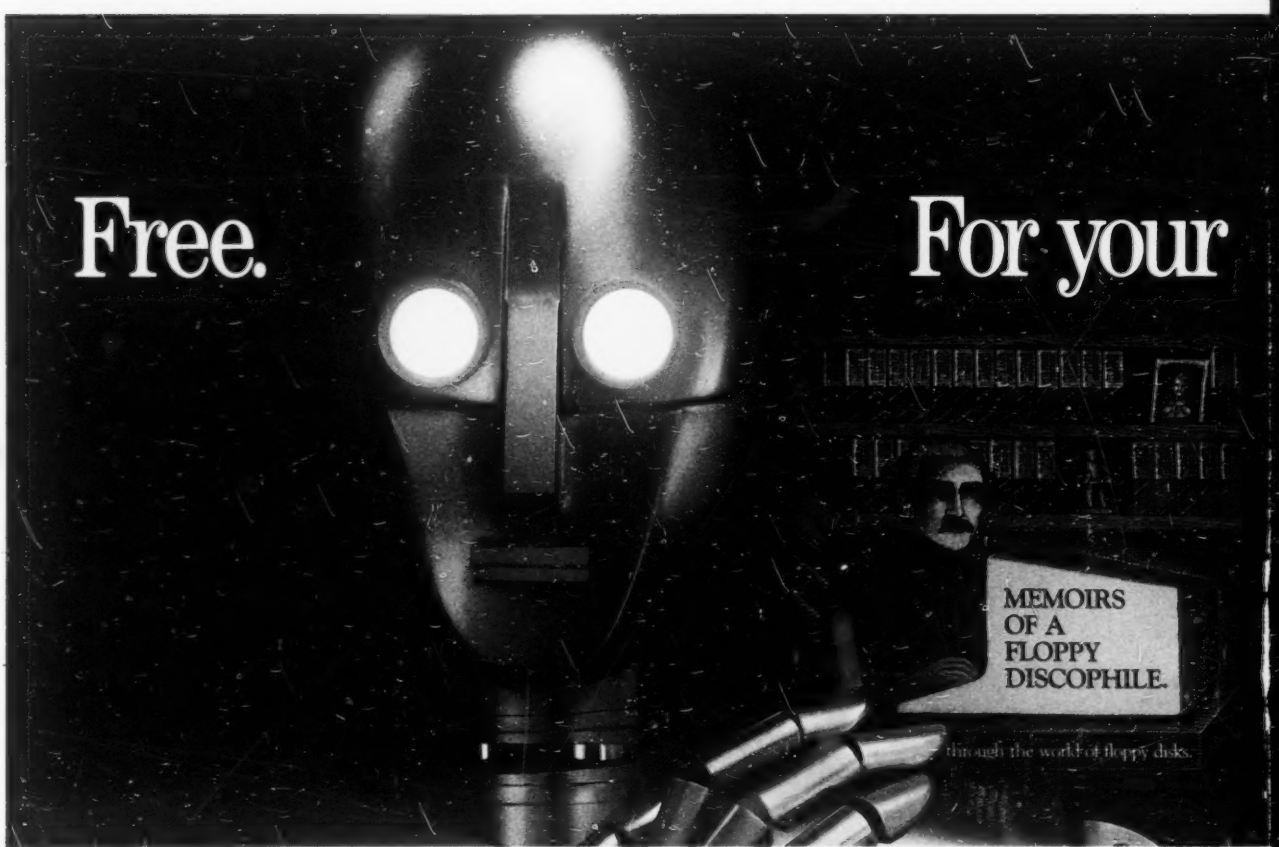
This could prove to be understated. A McGraw-Hill spokesman said he feels it is possible that the picture could start to look better to company managers if the dollar and interest rates keep heading lower. He adds that "spending plans could pick up over the next 12 months."

Also a positive sign for the long term: Preliminary figures for 1987 are unchanged from 1986. Historically, figures projected this far out have tended to be low—reflecting long-term investment uncertainties on the part of some of the survey respondents.

The new study also reveals that this time around there will be quite a significant amount of industry-by-industry variation in demand, price, and capital investment. Aerospace and instrument firms, for example, are looking forward to 10-11% real gains in demand. The steel industry sees a sizable 6.7% advance

But look for fractional demand losses in a few areas—notably in paper, petroleum, and non-electric machinery. The latter seems to support other survey findings calling for a pause in capital spending.

Price projections are also all over the lot. The best performance—at least from a buyer's viewpoint—should be steel (where fractional 0.7% price decline is projected for 1986). If true, it suggests that the industry doesn't have too much faith in the price increases scheduled to



go into effect this month.

Other favorable price patterns are projected for the automotive and petroleum industries (both unchanged), textiles (up less than 1%), and chemicals (up just 2.6%). Food and beverages, with only a 2% anticipated rise for 1986, won't fare that badly either.

Some really ambitious price boosting plans are anticipated for the paper industry where a 7% advance is seen. This could reflect the industry's hope to recoup some of its price reductions of the past year. But judging from some of the forecasts made by econometric models, the industry may have to settle for a lot less.

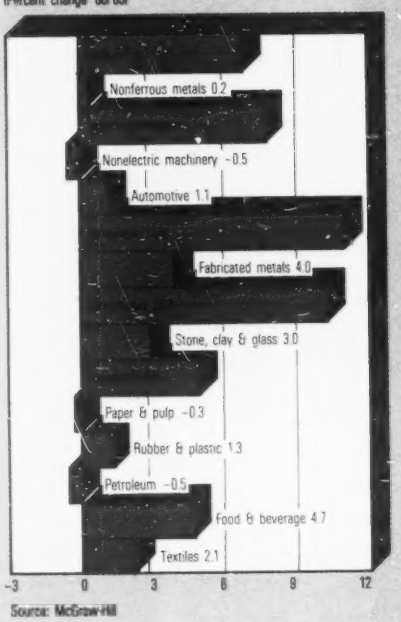
Another relatively high inflation rate is projected by the communications industry. The 1986 increase for this sector is put at just over 7%. But again this seems questionable in view of demand forecasts which actually call for a 1.5% decrease in sales.

Wide variation about overall averages also shows up in plant and equipment projections. In a few areas like paper and the plastics groups, nominal dollar gains of 10% or more are projected. But offsetting this are declines in capital spending for steel, textiles, non-electric machinery, and stone-clay-glass.

The steel decline, however, could prove temporary—a hefty 44% increase in capital spending is projected in 1987. If correct, it is a good sign that executives in this hard-pressed industry are not about to throw in the towel—and apparently are planning a major modernization program to stay competitive with their offshore counterparts. ***PW***

Ditto real sales gains

(Percent change '86/'85)



Source: McGraw-Hill

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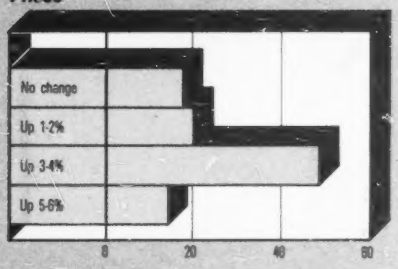
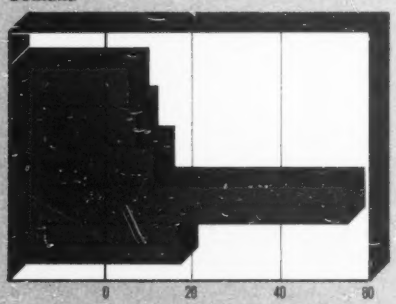
How PW readers view '86: Four views

(Percent of respondents)

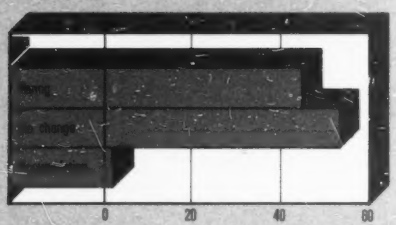
Prices



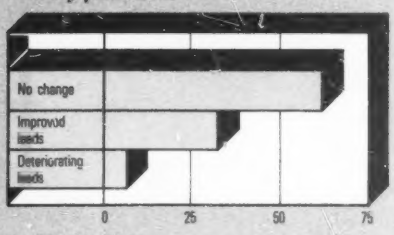
Demand



Inventories



Delivery performance



Source: PurchasingWorld

Buyers still playing it close to vest

PW's readers are looking forward to a fairly good 1986.

That's not to say they expect a return to the boom days of 1983. But they do see some good-sized gains for their companies. They also say that price increases will remain quite moderate—with no major procurement problems anticipated.

As one respondent to a new nationwide *PurchasingWorld* survey puts it, "There's very little evidence to suggest any major change in our operations. Orders are coming in at a fairly good clip and the prices we are negotiating look only a bit higher than in 1985."

In a nutshell, here's the scenario he and his fellow buyers are now painting for the next four quarters:

- **1986 price trends:** The average advance in company procurement costs is put at 2.8%. An overwhelming 86% of those buyers queried estimate that they will be able to hold their own specific increase to 4% or less. On the other hand, nearly three out of five say there could be some acceleration after mid-year.
- **1986 versus 1985 prices:** This year's price picture won't be as good as 1985. Specifically, nearly half of the respondents see increases running a bit higher than last year's. Only 20% said they might be able to hold hikes under 1985 levels.
- **1986 demand trends:** The majority of PMs (56%) feel that their own firm's activity will be up anywhere from 1-4%. And a modest 17% see even bigger gains. On the other hand, a few respondents see declines. The average projected increase is just under 2%.

This is pretty much in line with what the econometric models are projecting. An average of four leading models suggests little more than a 1.5% boost in industrial production in 1986.

PW readers also feel that GNP is likely to accelerate as the year progresses. 41% see larger gains for the second half compared to only 10% who see smaller gains.

- **Inventory plans:** "Close-to-the-vest" is still the order of the day. More than two out of five PMs queried plan to do some stock paring over the next few months, despite the fact that nearly 75% see their own firm's activity still on the rise.
- **Availability:** There won't be any big problems here. Many more respondents anticipate improved lead-times (32%) than stretchouts (7%), even though demand is expected to increase.

Only two respondents mentioned the possibility of shortages—and in one case it stemmed from fears of a steel strike which most labor analysts feel is only a remote possibility.

But the year won't be totally problem free. Some of the worries noted by readers: 1) elimination of competitive sources because of mergers or business failures, 2) the possibility of higher interest rates if the deficit stays near current peaks, and 3) the tendency for more and more standard items to become special order items.

A few readers also expressed concern over price increases—not only overall as the year wears on, but also in such specific sectors as structural steel and corrugated. The latter is traceable to the shift of some corrugated mills over to coarse and fine paper production.

Whatever the problems, most PMs have their 1986 purchasing strategies worked out. Quite a few are hoping to rely more on imports to help keep a lid on prices. An equally large number are concentrating on fewer sources and long-term commitments in return for price concessions or longer price protection in new contracts.

Other ploys to optimize purchasing effectiveness in the year ahead include 1) reduced inventories and just-in-time ordering, 2) pressing for shorter lead times, and 3) increased

...continued

Price outlook through 1987
(comparison of fourth quarter pricing)

Product	Percent change 85/84	86/85	87/86
Raw materials, energy			
Residual fuels	-18.3	-6.6	0
Industrial chemicals	1.6	1.1	4.0
Prepared paint	0.4	3.1	3.8
Supplies for manufacturing	1.8	3.8	4.3
Metals			
Steel mill products	-0.4	4.2	4.6
Foundry & forge shop products	0.6	4.2	4.6
Primary aluminum (ex extrusions)	-3.7	3.5	4.9
Nickel sheet	-0.1	2.2	8.1
Zinc die casting alloy	9.1	3.6	5.7
Copper & brass mill shapes	1.2	4.2	8.5
Components			
Explosives	-0.8	3.2	5.2
Pulp & paper products	-3.0	3.7	4.1
Motors & generators	3.2	5.6	5.9
Electronic parts	1.2	2.9	5.3
Relays	-1.8	3.1	4.7
Refractories	2.6	2.4	4.3
Construction Products			
Laminated plastic sheets	0.1	3.4	4.7
Concrete rebars	2.9	3.9	3.9
Heavy structural shapes	1.2	3.5	6.2
Plumbing fixtures	2.1	5.5	4.7
Asphalt roofing	1.0	1.5	2.5
Construction materials	3.5	7.9	6.5
Machinery			
Heating equipment	2.5	3.1	3.7
Metalworking machinery	1.9	4.3	4.3
General purpose machinery	2.2	3.0	4.8
Mining machinery	0.7	0.9	4.8

emphasis on quality and service.

One midwestern purchasing executive sums it all up, "there's no reason why we can't continue to call most of the signals—what with today's more-than-ample supplies, import competition, quick delivery, and quality. Right now we are targeting for only a 1-2% increase in procurement costs—and there's an outside chance we might even do better than that." ***PW***

Prices to tick up a tad

Count on very modest price increases for most industrial products—not only for 1986 but for the following year as well.

If new DRI projections hold true, the overall advance in 1987 will be only about 3%—not that much above the 1.5% gain anticipated during the next 12 months.

Factors behind this optimistic forecast include 1) no major changes in labor costs (private industry wage and salary increases will be only 4.1% in 1986 and 4.9% in 1987), 2) continued softness in the energy sector, and 3) relatively restrained demand gains. Industrial production will advance only 1.3% over the next four quarters.

With this in mind, here's a more specific rundown of DRI's price projections for key industrial sectors:

- **Crude oil:** Prices should decline at an average quarterly rate of 2.2% into early 1987 before an economic rebound leads to stronger energy demand and arrests the slide. But even then (during the last three quarters of 1987), the increases should be minimal—only 0.2% per quarter.
- **Natural gas:** Declines are likely here, too, because of softness in competing resid fuel oil and relatively flat demand. Best bet: Natural gas will drop at an average quarterly rate of 1.7% into early 1987. Beyond that (2Q through 4Q 1987) look for stabilization as crude oil prices bottom out.
- **Electricity:** Flat or declining costs for primary fuel inputs will still limit rate hikes. The cost of coal, the major raw material, will remain virtually flat through 1986—posting only a 0.3% average quarterly gain before it rebounds to 0.7% per quarter in 1987. Prices for electricity, accordingly, will advance at an average quarterly rate of 0.3-0.4% over the forecast period.
- **Industrial chemicals:** Declining hydrocarbon feedstock costs and slackening end-market demand in 1986 will combine to suppress increases. Thus the producer price index for industrial chemicals indicates an average quarterly escalation rate of 0.3% through 1986—and only a slightly more robust 0.7% over the following year.
- **Steel:** A modest drop in imports should help firm prices despite slow growth in overall consumption by steel-using industries. In 1986, the aggregate index for steel mill product prices should move up 3.1%. And in 1987, when stronger markets give more support to higher prices, the annual increase will be around 4.0%.
- **Nonferrous metals:** The current slump should continue for another two quarters on a combination of sluggish end-market demand and a worldwide capacity glut. All in all, average quarterly growth rates should climb only 0.4% into third quarter 1986. By 1987, however, increased consumption (especially in transportation) will spur moderate acceleration. The average quarterly increase for 1987 is estimated at nearly 1.6%.
- **Construction materials:** A 1986 fall-off in non-residential construction and weak energy prices counteract the impact of healthy residential building levels—thus keeping price hikes down. Gypsum products should increase by just 0.5% in 1986 and by 3.7% in 1987. Prices for insulation materials are forecasted to move up only 1.1% and 2.5% in 1986 and 1987.
- **Machinery:** Because price competition will remain necessary to survival, price increases will do little

What the big econometric models predict

Real GNP (% change)	1986	1987
DRI	2.1	3.8
Chase	2.5	3.1
Wharton	2.4	3.8
Merrill Lynch	3.0	3.0
AVERAGE	2.5	3.4
Industrial production (% change)		
DRI	1.3	5.6
Chase	1.3	4.7
Wharton	1.6	3.9
Merrill Lynch	2.9	3.4
AVERAGE	1.8	4.4
GNP price deflator (% change)		
DRI	3.2	4.0
Chase	4.1	4.4
Wharton	3.4	4.3
Merrill Lynch	3.4	5.1
AVERAGE	3.5	4.5
Finished producer prices (% change)		
DRI	1.8	3.2
Chase	2.4	3.3
Wharton	2.0	5.1
Merrill Lynch	2.1	4.3
AVERAGE	2.1	4.0
Consumer prices (% change)		
DRI	3.3	4.0
Chase	3.9	4.5
Wharton	3.3	4.1
Merrill Lynch	3.4	4.8
AVERAGE	3.5	4.4
Prime interest rate (%)		
DRI	9.0	10.0
Chase	9.3	9.9
Wharton	9.1	10.5
Merrill Lynch	9.3	11.0
AVERAGE	9.2	10.4
Unemployment rate (%)		
DRI	7.5	7.4
Chase	7.0	6.5
Wharton	7.3	6.8
Merrill Lynch	7.1	6.8
AVERAGE	7.2	6.9

aggregate price index for all machinery and equipment is expected to increase only 2.9% and 4.2% in 1986 and 1987.

■ **Electronic components:** Prices should strengthen over the near term as slowing output rates combine with improved end-market activity to reduce current large inventories. The aggregate electronic components price index will show average annual increases of 3% be-

passive components will outpace active components by a wide margin.

■ **Freight:** Only moderate cost pressures are projected for both air freight and interstate trucking—with no increase in air freight and only a 0.6% rise for trucking in 1986. But as oil prices stabilize in 1987, average quarterly escalation rates in air freight and trucking costs should accelerate to 0.6% and 0.9% respectively.

Models take a close fix on '86

The closeness in readings of the four leading econometric models—a point or less variance from the averages—is an encouraging sign of forecast consensus of where the economy is heading in the next year or so. This adds an extra note of confidence to these mathematically-oriented, computer-massaged predictions.

What they signal is also reassuring: modest growth without a recession in 1986. And 1987 looks even better as far as overall economic activity is concerned. Although there will be some price acceleration by 1987, it will be modest. Key price indices at that time should run up only about 4-4.5%.

Also reassuring is that 1986 forecasts are even more positive than those made a year ago for 1986 (*PW Jan. 1985*). Both GNP and production gains for the upcoming year are now a bit more robust. And projected rate hikes have been reduced anywhere from 1.5-2.0%.

Another reassuring note is that these four models were pretty much on the button for 1985. As long ago as January 1985, they were calling for a 3.0% GNP gain—very close to the latest government estimate of 2.4%. Similarly, the earlier GNP price deflator estimate for the year just ended was 4.3%—not all that different from the latest reading of 3.7%.

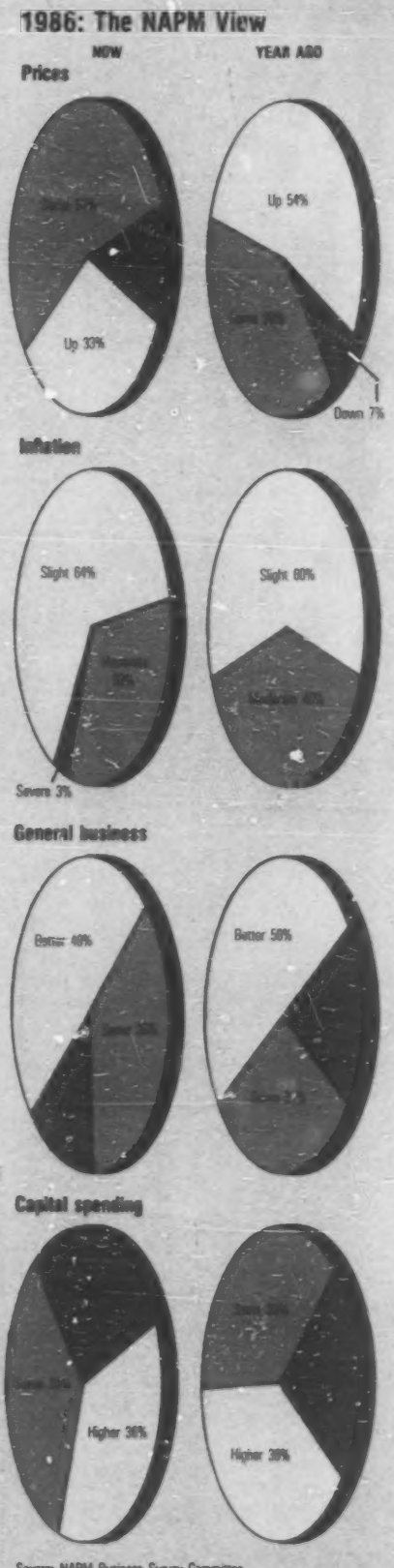
A closer look at 1986 and 1987 forecasts shows the following:

■ **Growth:** The 1% average acceleration in real GNP from 1986 to 1987—from 2.5% to 3.4%—indicates clearly that things will be getting better as the months wear on. Also a sizable 4.4% jump in industrial production anticipated for 1987 indicates there is still quite a bit of life in the manufacturing sector.

■ **Prices:** While there could be fractional deceleration in the 1986 price deflator—from 3.7% in 1985 to 3.5% in 1986—finished producer prices could accelerate from just under 1% last year to just over 2% in 1986. And only modest acceleration—4.5% in the GNP price deflator and 4.0% in the finished producer price index—is seen for 1987.

■ **Interest rates**: Relatively slow GNP growth should hold the prime rate down near 9% in 1986. But slowly intensifying demand and price pressures envisioned for the following year (1987) could force it up about 1-1.5%.

■ **Unemployment:** Things won't get worse. And they won't get much better either because demand growth envisioned over the forecast period will be offset by increases in the labor force and fractional productivity gains—thereby holding the jobless rate right around the 7% mark. ***PW***



Source: NAPM Business Survey Committee

NAPM says '86 will top '85

NAPM's Business Survey Committee is guardedly optimistic about the economy in 1986.

Although the group's 250 reporting members do not see any substantial advances in the quarters ahead, the majority feel the year will be better than 1985—with little inflation.

Robert J. Bretz, committee chairman and director of purchasing and distribution at Pitney Bowes, sums up the view of most of the PMs who were queried for the the survey: "Looking at all the replies suggests that we can probably look forward to about a 3% real growth rate over the year—with industrial procurement prices likely to rise by only 2%."

He hastens to add, however, that purchasing executives have some concerns. They are a bit worried about rising prices on some imports if (1) the dollar continues to deteriorate and (2) new import quotas restrict volume.

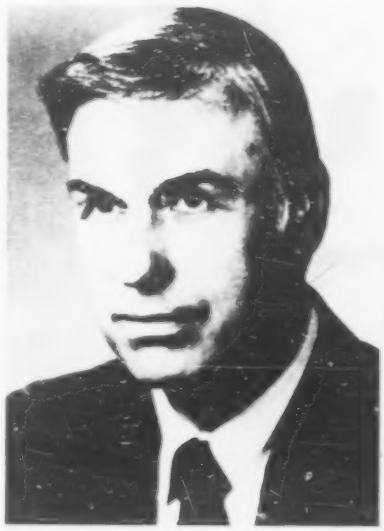
A few capital goods companies are also keeping a weather eye on proposed tax law changes, fearing that any tightening up of investment incentives could adversely affect the demand for machinery and equipment.

These uncertainties are probably why some 60% of the survey respondents say they are concerned about the next 12 months—a figure that has been rising steadily from 27% in May 1984 to 56% last spring.

Despite these worries the feeling is that we will remain in the plus column through all of 1986—with specifics shaping up along these lines:

- **Prices:** No real concern here. Two out of three surveyed PMs expect unchanged or lower prices over the next six months. That's better than a year ago when only 46% saw prices unchanged for 1985.

Moreover, 13% of these PMs are predicting lower prices in 1986. That figure has only been exceeded twice before in the history of the NAPM business survey—in May 1982 and December 1974—when we were in the depths of a recession.



Robert J. Bretz C.P.M., Chairman, NAPM Business Survey Committee and Direct of Purchasing and Distribution, Pitney Bowes, Inc.

Also encouraging is that three out of five purchasing executives expect price increases to be small.

- **Real growth:** Those predicting an increase for all of 1986 (49% of the respondents) outnumbered those seeing a decline (15%) by better than 3:1. But there is a hint of some deceleration after mid-year. Only 37% put the second half of 1986 above the first half.
- **Capital spending:** Only a moderate increase is suggested. The 36% who see increases here in 1986 are offset by the 30% who see declines and the remaining 34% who anticipate no change. The fact that a hefty 73% of the surveyed firms report operating rates under 90% (the same as last year) could be a factor behind this cautious approach. ***PW***